

Land sold for residential development

(Lecture B1165 – 12.42 minutes)

Case study

Farmer Giles owns 10 acres of land jointly with his wife and daughter. The land has generated income from grazing rights over the last 10 years i.e. another farmer has paid them to put his sheep on the land. The Giles are not VAT registered for this source of income because the turnover has always been below the compulsory threshold. The land has a current market value of £500,000 but this figure could increase to £2m if the land is sold with planning permission in place to build dwellings. In order to achieve this enhanced value, the Giles family will require the services of a land professional, who will take on the role of 'promoter' in order to obtain planning permission from the local authority. The promoter's fee will be based on 20% of the increased land value i.e. £300,000 plus VAT.

Liability of land sale

There is often a view among the farming community that all of their income is zero-rated. Farmers like this outcome because no VAT is charged on their income but they still get input tax recovery on their expenses.

However, the key point with a land sale is that it will be exempt from VAT in 99% of cases (never say 'always' in the VAT world – it is the exceptions that keep us on our toes) unless the seller has made an option to tax election in which case it will be standard rated. A land sale will never be zero-rated. This means that input tax can be reclaimed on expenses if an option to tax election is made and VAT is charged on the land sale but not if it is sold as VAT exempt.

VAT registration

The first important point is to always remember that jointly owned land is a partnership as far as VAT is concerned. I still have the occasional challenge from solicitors who claim that jointly owned land represents separate sole trader businesses with each owning a proportion of the land. This is not correct and is helpfully confirmed by VAT Notice 742A, para 7.3.

There is a planning opportunity for the Giles family, namely that they could register for VAT as a partnership and backdate their registration date up to four years ago. The reason is because the grazing rights income they have earned is zero-rated – it is classed as a supply of animal feeding stuff rather than a supply of rental income (HMRC Manual VFOOD3120). Don't forget that zero-rated income is still 'taxable' – you are charging VAT to your customers but at a rate of 0%.

The Giles' registration will be voluntary because the grazing rights income has never exceeded the compulsory registration threshold. But it means that input tax can be claimed retrospectively on any costs that they have incurred, even if this is just accountancy fees for completing partnership accounts and fertiliser used on the land.

Option to tax election

Although we are registering the Giles family for VAT back to 2015, the option to tax election will still be made from a current date. You cannot retrospectively opt to tax, and there is no reason to do so because there has been no past exempt income in the equation. The best time to opt is just before the first costs are incurred that relate to the potential sale of the land i.e. so that they will directly relate to a taxable supply. Although the land promoters don't usually charge a fee until the land is sold, there are usually other costs that are paid out at the planning stage of a project.

Note – the option to tax election will be made by submitting form VAT1614A to HMRC.

An option to tax election is not always a complete 'win win' outcome. And there are three potential disadvantages to consider:

Input tax for buyer - the land sale might be made to a business that cannot claim input tax. This will not be an issue if the sale is to a developer who will construct and sell zero-rated dwellings on a freehold basis or a lease exceeding 21 years (20 years in Scotland) but might be a problem if the developer intends to rent them out when the project is completed i.e. generating exempt income. The buyer will also have a cash flow challenge of paying VAT and then waiting up to three months to claim input tax. However, most developers will submit monthly VAT returns because they are usually in a VAT repayment situation, so this will hopefully be a minor obstacle.

Stamp duty land tax – this tax is always based on the VAT inclusive price of a property deal and is paid by the buyer. It is worth checking whether the increased SDLT payment caused by the VAT charge exceeds the input tax gain acquired by the seller who has opted to tax – the answer will almost certainly be 'no' in the case of projects such as the Giles family because of the big fees charged by the promoters.

Housing association – if land is sold to a housing association, it has the opportunity to issue VAT1614G to the seller before the deal takes place if it intends to build new dwellings, which means the land sale will be exempt again rather than standard rated i.e. the option to tax election is overridden. This creates a cost to the seller with the loss of input tax on related costs. In reality, most land promoters are aware of this pitfall and tend to steer clear of housing associations in their search for a willing buyer (VAT Notice 742A, para 3.6).

Abortive project

It can often take a long time for planning permission to be granted and sometimes it will be refused by the authorities. What would the position be if the Giles family incurred some costs on their proposed land sale and claimed input tax but then the project never progressed to a happy ending, perhaps because the land was unsuitable for housing?

Will HMRC expect a refund of any input tax claimed by the landowner on the basis that it will not pocket any output tax if the project is aborted? The good news is that the answer is 'no' as long as the sale would have been taxable. (VAT Notice 706, para 13.14).

Deregistration

Let's move forward to the most important VAT return i.e. the one that includes the eventual land sale. The £2m sale will be subject to output tax of £400,000 but input tax of £60,000 will be claimed on the £300,000 fee being charged by the promoter. There might be other input tax to claim as well e.g. conveyancing fees.

However, once the Giles family has made its only taxable sale, and declared this on the correct VAT return, it should then deregister, unless it intends to make future taxable supplies through the same legal entity. That will be unlikely in most cases.

Contributed by Neil Warren